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February 21, 2007

## **AGENDA ITEM 5**

### **TO: THE MEMBERS OF THE HEALTH BENEFITS COMMITTEE**

- I. SUBJECT:** Implementation of Other Post-Employment Benefits (OPEB) Pre-funding Program
- II. PROGRAM:** Enterprise-wide
- III. RECOMMENDATION:** Staff Recommends that the Committee Recommend to the Board that Implementation of the OPEB Program Continue and that CalPERS Begin to Accept, Invest and Track OPEB Contributions from Public Employees' Medical and Hospital Care Act (PEMHCA) Employers
- IV. BACKGROUND:**

Health benefits provided through CalPERS health plans are currently funded through employer, employee, and retiree contributions. For most employers the contributions are not pre-funded, but rather are designed to fund premium costs on an annual basis. Pre-funding is a means of enhancing the security of health care benefits for retirees. This process provides money dedicated to retiree health care which could be more secure than depending upon pay-as-you-go funding. Pay-as-you-go funding may be subject to economic cycles so that employer payments could be reduced during economic downturns and/or the range of covered health benefits could be reduced.

Since 1992, the Financial Accounting Standards Board in FAS 106, has required employers in the private sector to measure their obligations for retiree health liabilities, to post a measure for the unfunded post retirement health liability on their balance sheets, to post the annual expense for these benefits in the income statement, and to disclose the unfunded liability and expense in the footnotes in their financial statements. Now, the Governmental Accounting Standards Board (GASB) Statement 45 has extended the concepts of FAS 106 to governmental entities by approving accounting and financial reporting requirements for employers for Post-Employment Benefit Plans other than Pension Plans (GASB 43) and for

Post-Employment Benefits other than Pensions (GASB 45). The new requirements will be implemented in three phases (depending on the size of the governmental entity) with the first phase taking effect for reporting periods beginning after December 15, 2005 for plans under GASB 43 and after December 15, 2006 for employers under GASB 45.

*Current Law-Annuitants' Health Care Coverage Fund*

The Legislature recognized a need to establish a means for pre-funding retiree health benefits and in 1988 it adopted a law (Stats. 1988, ch. 331) that created the Annuitants' Health Care Coverage Fund (AHCCF) for the purpose of pre-funding health care coverage for annuitants. The law allows a PEMHCA employer to elect to participate in the pre-funding plan. The law provides further that the CalPERS board has sole and exclusive control and power over the administration and investment of the AHCCF.

GASB 45 requires government employers to report in their financial statements the estimated costs and liabilities associated with post-employment health benefits for current and future retirees. The AHCCF will provide a vehicle for participating employers to contribute an amount to cover some or all of their expected liabilities for health care coverage for annuitants. The AHCCF would serve the purposes of enhancing security for retirees, and providing employers a choice of investment vehicles implementing California Government Code sections 22940 *et seq.*

**V. ANALYSIS:**

Based on direction from the Board at the May 2006 Board meeting, CalPERS staff has continued to implement a three phased approach to assist Contracting Agencies in becoming compliant with GASB 45. The three phases are as follows:

**Phase I – Data Extract to Perform Health Care Actuarial Valuations**

CalPERS will provide the Contracting Agencies the participant and beneficiary data needed for an accurate OPEB actuarial valuation. This will assist the Contracting Agencies and the actuarial firms providing the valuation services. The appropriate data extract has been identified and is now available to contracting agencies. This process is ongoing.

**Phase II – OPEB Actuarial Assumption Model, and Pre-funding Tracking Mechanism**

Under Phase II, staff was directed to develop a standard OPEB Actuarial Valuation assumption model and make such a model available to contracting agencies who may wish to pre-fund through a CalPERS sponsored pre-funding mechanism. The

pre-funding assumption model was approved by the Board in November and is now available to contracting agencies and their consulting actuaries.

In addition, under Phase II, staff was to develop a Pre-funding Tracking Mechanism and standard agreement to be signed by contracting agencies that choose to pre-fund their GASB obligations through CalPERS. The standard agreement has been completed. Earlier drafts of the agreement were shared with a sample of employer and employees groups to ensure that the agreement addressed appropriate issues of concern to both CalPERS and constituent groups.

As part of the process of establishing a pre-funding tracking mechanism, staff also completed, and the Board approved, regulations to clarify and make specific existing provisions in PEMHCA. These regulations were approved by the Board in December and filed with the Office of Administrative Law. The regulations were approved and filed with the Secretary of State and became effective on January 26, 2007.

Informational materials for employers explaining how to request their data extract, the actuarial model, and standard agreement have been developed and are available for employers. These materials, and “frequently asked questions” will be available on our Web site. In addition, all information has been provided to the CalPERS Contact Center to ensure that interested employers will be able to access individuals with appropriate knowledge to assist them in their requests.

### **Phase III – Detailed Business Case**

The final Phase approved by the Board was the completion of a detailed business case study that would identify the requirements and costs to assist the CalPERS Board in the decision of whether CalPERS should create a new fully integrated program for pre-funding retiree health benefits that would expand beyond the accepting and tracking of funds. A consultant has been engaged to complete this analysis and staff anticipates bringing the results of the study to the Board in July. The study will cover the items identified below.

- ✓ Perform best practices
  - Other pension systems have decided to move forward with pre-funding health benefits
- ✓ Identify, develop, and document business and technical requirements for the Investment Component, Actuarial Component, and Pre-funding Program
  - Includes evaluation of current systems and estimated costs
- ✓ Documentation of to-be process models
- ✓ Determination of staff allocation for all areas (Investments, Actuarial, and Pre-funding Program)
- ✓ Recommendation of organizational structure
- ✓ Perform gap analysis

- ✓ Evaluate a pre-funding system to handle enrollment data, contract information, detailed plan provisions, and collection/payment capabilities

## **VI. Discussion**

Activities required to complete or commence the task identified under each of the three phases have occurred and are continuing. With completion of the standard actuarial assumptions model and standard agreement for accepting and tracking pre-funding health benefit monies, staff feels CalPERS is ready to actually begin accepting monies from contracting agencies. At this time, under current law, CalPERS will only be able to accept contributions from agencies that are currently members of PEMHCA.

The Board was the sponsor of SB 1729 which was vetoed by the Governor in September 2006. The bill would have allowed all public agencies to contract with CalPERS to pre-fund their OPEB obligations. Currently, staff continues to work with interested parties to bring this legislation before the Governor again this year.

## **VII. Strategic Plan**

This item supports Goal I of the Strategic plan which states, "Exercise global leadership to ensure the sustainability of CalPERS pension and health benefit systems."

This program will have an impact on existing core workload for the Actuarial & Employer Services Branch, Legal Office, Investment Office, Fiscal Services Division and Health Benefits Branch. This item also has future possibilities of reducing State and Contracting Agencies' health care liabilities by changing retiree health care premiums from a "pay-as-you-go" basis to pre-funding the benefits and investing the funds.

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